
CHAPTER 2

2-000 Preaward Surveys of Prospective Contractor Accounting Systems

2-101 Preaward Survey Overview

A preaward survey is an evaluation, usually made by the cognizant contract administration office, of a prospective contractor's ability to perform a proposed contract. Such surveys may cover technical, production, quality assurance, financial capability, accounting system, and other considerations. Normally, there are two categories of information that DCAA may be requested to furnish. One deals with the contractor's financial capability to perform the contract and the other deals with the adequacy of the accounting system to accumulate the type of cost information required by the contract.

2-201 Financial Condition Risk Assessments or Financial Capability Audits

Financial condition risk assessments or financial capability audits are performed to determine if the contractor is financially capable of performing on Government contracts. These risk assessments or audits may be performed during the preaward or post contract award periods. The type of financial information examined by DCAA consists of such data as: (1) financial statements, including those contained in reports issued to stockholders, lending institutions, and SEC filings, (2) cash flow forecasts, (3) loan agreements and evidence showing compliance with these agreements, (4) aging of accounts receivable and payable, and (5) financial history of the contractor and affiliated concerns, and (6) employee payroll tax returns (Federal). Based on this information, the auditor will make a recommendation to the contracting officer regarding whether or not a contractor has sufficient financial resources to perform the contract.

2-301 Accounting System

2-301.1 Accounting System Surveys - General

a. The preaward accounting system survey is an audit to determine the acceptability of a contractor's accounting system for accumulating costs under a prospective Government contract. The audit scope should be limited to obtaining an understanding of the design of the prospective accounting system so as to appropriately complete the SF 1408, "Preaward Survey of Prospective Contractor Accounting System" (see Figure 2-3-1 and refer to paragraph 2-301.2 for additional discussion), and those procedures essential to reach an informed opinion as to whether or not the design is acceptable for accumulating costs under a Government contract. In addition to the items on the SF 1408 evaluation checklist, DCAA will determine if the system will provide reasonable data for projection of costs to complete a contract.

b. Contractors should recognize that an operable accounting system that is under general ledger control is of paramount importance when performing Government contracts. However, prospective contractors may have no work that requires the same type of accounting system as is needed for Government work. A prospective contractor may not

want to install a new, more detailed accounting system unless awarded a contract. In this case, if the potential contractor anticipates a contract award, it must have developed a system that is operable, though not necessarily in use. It must be in a position to demonstrate this new system to the auditor and be ready to implement the system prior to incurring any costs on the Government contract. In developing their contract cost accounting systems, new companies often benefit from employing personnel or consultants who understand rules and regulations applicable to accounting for costs incurred on Government contracts.

c. If the accounting system is unacceptable, the auditor will promptly notify both the contractor and the procurement official of the deficiencies, and will usually identify recommendations for correcting the deficiencies. DCAA will not develop the new system, since this is the contractor's responsibility. Once the required corrective actions have been taken by the contractor to correct the deficiencies, DCAA, if requested by the contracting officer, will perform a follow-up audit of the revised system and/or corrected deficiencies.

d. An accounting system audit may be performed after contract award. The major objective is to determine if the contractor's accounting system is adequate for accumulating and billing costs on Government contracts. It is usually performed at the request of the contracting officer when (1) a follow-up to a preaward survey is recommended, or (2) a preaward survey was not conducted prior to contract award, and the contracting officer determines that an audit is now required to support contract requirements. Auditors may self-initiate a post contract award accounting system audit based on audit risk at a contractor location.

2-301.2 Detailed Provisions of SF 1408 (Reference Figure 2-3-1, Page 2 of 2)

a. Proper segregation of direct costs from indirect costs. DCAA will review the accounting system to determine if direct costs are segregated from indirect costs. Direct costs are defined in FAR 31.202 as any cost that can be identified specifically with a particular final cost objective (e.g., a contract). An example would be labor specifically identified to the contract, or materials purchased specifically for the contract. Contractors at times may find it impractical to identify costs specifically to a contract. FAR 31.202 states that a direct cost can be treated as an indirect cost if the dollar amount is minor, it is treated the same way for all contracts in a contractor's accounting system, and that treatment produces substantially the same results as treating the cost as a direct cost. Indirect costs are defined in FAR 31.203 as any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. An example of an indirect cost would be the lighting in a manufacturing area that houses the work of several contracts. The lighting benefits all contracts, but cannot practically be identified to a specific contract. These types of costs are normally placed in an overhead or general and administrative (G&A) expense pool and allocated to contracts on some equitable basis. The cost accounting system must identify what costs are considered direct, and what costs are considered indirect. Once these criteria are defined, they must be consistently applied.

b. Identification and accumulation of direct costs by contract. DCAA will determine if the accounting system can accumulate costs by contract (commonly referred to as a job order cost accounting system).

c. A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives. DCAA will determine if indirect costs are allocated to cost objectives based upon relative benefits received, or other equitable relationship, as required by FAR 31-201-4, "Determining allocability," and 31-203, "Indirect costs." Fundamentally, this means that a cost may not be allocated as an indirect cost to a final cost objective if other costs incurred for the same purpose have been included as direct costs of that or any other cost objective. If superficially similar costs are treated as both direct and indirect costs, the purposes for incurring the costs must be distinguishable. For example, if a contractor wishes to perform a contract which requires three firemen on 24-hour duty at a fixed-post to provide protection against damage to highly flammable materials used on the contract, but the contractor already has a firefighting force for general protection of the plant, which is treated as an indirect cost and allocated to all contracts, the contractor may charge the cost of three of the post firemen directly to the particular contract requiring them. In this example, the contractor may also allocate a portion of the remaining cost of the general firefighting force to the same contract only if the separate classes of firemen can be shown to serve different purposes consistently (that is: (a) costs charged directly to the contract are only costs of three contract-required firemen at a fixed post who are protecting contract materials, and (b) no costs of these firemen are ever included in the indirect cost pool).

d. Accumulation of costs under general ledger control. DCAA will determine if the job order cost accounting system can be reconciled with the general ledger, and that the company accounting system is controlled by the general ledger.

e. A timekeeping system that identifies employees' labor by intermediate or final cost objectives. DCAA will determine whether a contractor's timekeeping system has the ability to track employees' time spent on each work activity. (See Section 2-302 for further information on timekeeping procedures and controls.)

f. A labor distribution system that charges direct and indirect labor to the appropriate cost objectives. This is interconnected with the discussion of timekeeping. Once an employee's time is segregated as described in paragraph 2-301.2e, the costs must be allocated to the appropriate cost objective(s).

g. Interim (at least monthly) determination of costs charged to a contract through routine posting to books of account. DCAA will determine if the accounting system produces appropriate reports that show the results of charges to contracts. These reports should be produced at least monthly.

h. Exclusion from costs charged to Government contracts of amounts that are not allowable pursuant to FAR Part 31, Contract Cost Principles and Procedures, or other contract provisions. The FAR identifies some costs as expressly unallowable: e.g., bad debts (FAR 31.205-3); contingencies (FAR 31.205-7); contributions or donations (FAR 31-205-8); and entertainment (FAR 31.205-14), and requires that they be excluded from proposals and billings. Costs mutually agreed to be unallowable between the contractor and the contracting officer also may not be proposed or billed. DCAA will determine if the accounting system

identifies these expressly unallowable costs and segregates them in the books and records (or on some alternate acceptable informal basis that readily reconciles with the books and records). While these costs may be legitimate business expenses, they will not be accepted by the U.S. Government as allowable contract costs. FAR 42.709 authorizes contracting officers to assess a penalty if a contractor claims an expressly unallowable cost in (1) the final indirect cost rate proposal or (2) the final statement of costs incurred or estimated to be incurred under a fixed-price incentive contract.

i. Identification of costs by contract line item and units (as if each unit or line item was a separate contract) if required by the proposed contract. Some contracts require that the cost of certain items be readily identifiable. In such cases, DCAA will review a contractor's accounting system to determine if a contractor can comply with such requirements.

j. Segregation of preproduction costs from production costs. DCAA will review a contractor's accounting system to determine that the costs can be identified in this manner.

2-302 Labor Charging System

Timekeeping procedures and controls on labor charges are areas of utmost concern. Unlike other costs, labor is not supported by external documentation or physical evidence to provide an independent check or balance. The key link in any sound labor time charging system is the individual employee. It is critical to labor charging internal control systems that management indoctrinates employees on their independent responsibility for accurately recording time charges. This is the single most important feature management can emphasize in recognizing its responsibility to owners, creditors, and customers to guard against fraud and waste in the labor charging function. To be effective, the internal controls over labor charging should meet the following criteria:

(1) There should be a segregation of responsibilities for labor-related activities; for example, the responsibility for timekeeping and payroll accounting should be separated. In addition, supervisors who are accountable for meeting contract budgets should not have the opportunity to initiate employee time charges. It is recognized that, for a very small company, this type of segregation may not be possible, whereas for a larger company, this type of segregation would be required in order to have good internal controls over labor costs.

(2) Procedures must be evident, clear-cut, and reasonable so there is no confusion concerning the reason for controls or misunderstanding as to what is and what is not permissible.

(3) Maintenance of controls must be continually verified and violations must be remedied through prompt and effective action, which serves as a deterrent to prospective violations.

(4) Individual employees must be constantly, although unobtrusively, made aware of controls that act as an effective deterrent against violations. Many businesses accomplish this by emphasizing the importance of timecard preparation in staff meetings, employee orientation, and through the posting of signs throughout the workplace that remind employees of the importance of accurate and current timecards.

2-302.1 Timecard Preparation

Detailed instructions for timecard preparation should be established through a timekeeping pamphlet and/or company procedure. An automated timekeeping system uses remote data entry terminals to record labor charging data directly to the computer for processing. Supporting documentation normally consists of machine printouts or reports showing data that, in a manual system, appears on source documents. When a manual system is in place, instructions should indicate that the employee is personally responsible for:

- (1) Recording his/her time on a daily basis.
- (2) Recording time on the timecard in ink.
- (3) The correct distribution of time by project numbers, contract number or name, or other identifiers for a particular assignment. To ensure accuracy, a listing of project numbers and their descriptions should be provided in writing to the employee.
- (4) Changes to the timecard. All changes should be lined through, with the employee's initials beside the change indicating the employee personally made the change and that the change is correct.
- (5) Recording all hours worked whether they are paid or not. This is necessary because labor costs and associated overheads are affected by total hours worked, not just paid hours worked. Therefore, labor rate computations and labor overhead costs should reflect all hours worked. Unpaid hours worked are termed "uncompensated overtime." Solicitations over the simplified acquisition threshold contain the provision at FAR 52.237-10, Identification of Uncompensated Overtime, which details disclosure requirements for uncompensated overtime.
- (6) Signing the timecard at the end of each work period.

2-302.2 Recommended Timekeeping Policy

- a. The supervisor should approve and cosign all timecards.
- b. The supervisor is prohibited from completing an employee's timecard unless the employee is absent for a prolonged period of time on some form of authorized leave. If the employee is on travel status, the supervisor for the employee may prepare a time sheet. Upon his or her return, the employee should turn in his/her time sheet and attach it to the one prepared by the supervisor.
- c. The guidance should state that the nature of the work determines the proper distribution of time, not availability of funding, type of contract, or other factors.
- d. The company policy should state that the accurate and complete preparation of timecards is a part of the employee's job. Careless or improper preparation may lead to disciplinary actions under company policies, as well as applicable Federal statutes.

2-302.3 Floor Checks

DCAA auditors periodically perform physical observations of work areas and inquiries of employees to determine if: (1) employees are actually at work, (2) employees are performing in their assigned job classification, and (3) employee time is charged to the appropriate job or indirect account. These types of audits are referred to as floor checks. DCAA will perform unannounced floor checks to determine the adequacy and accuracy of the timekeeping system for reimbursement of labor costs under cost reimbursable contracts.

2-302.4 Penalties for Labor Mischarging

a. The manipulation of charges to a contract may be subject to criminal charges under 18 United States Code (U.S.C.) 1001.

b. Subject to the facts surrounding participation, the following can be liable for the violation:

(1) Employees who fill in and sign the timecards with the false information.

(2) Supervisors who approve the timecards with the knowledge that they contain the false information.

(3) Managers and officers who know those facts and make the claim anyway by submitting the invoice based upon the false timecard.

(4) The company, in a case where the falsification is known by individuals who submit or who have authority to submit or disapprove the submission of invoices, or who are of a sufficiently high enough level in the company that the court will impute their knowledge to the corporation.

c. There does not have to be a direct contractual relationship between the Government and the employee who submitted the false timecard for the employee to be liable. A person may be liable even though he or she did not submit the fraudulent claim presented to the U.S. Government.

SECTION II - EVALUATION CHECKLIST			
MARK "X" IN THE APPROPRIATE COLUMN (Explain any deficiencies in SECTION I NARRATIVE)	YES	NO	NOT APPLICABLE
1. EXCEPT AS STATED IN SECTION I NARRATIVE, IS THE ACCOUNTING SYSTEM IN ACCORD WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES APPLICABLE IN THE CIRCUMSTANCES?			
2. ACCOUNTING SYSTEM PROVIDES FOR:			
a. Proper segregation of direct costs from indirect costs.			
b. Identification and accumulation of direct costs by contract.			
c. A logical and consistent method for the allocation of indirect costs to intermediate and final cost objectives. (A contract is a final cost objective.)			
d. Accumulation of costs under general ledger control.			
e. A timekeeping system that identifies employees' labor by intermediate or final cost objectives.			
f. A labor distribution system that charges direct and indirect labor to the appropriate cost objectives.			
g. Interim (at least monthly) determination of costs charged to a contract through routine posting of books of account.			
h. Exclusion from costs charged to government contracts of amounts which are not allowable in terms of FAR 31, Contract Cost Principles and Procedures, or other contract provisions.			
i. Identification of costs by contract line item and by units (as if each unit or line item were a separate contract) if required by the proposed contract.			
j. Segregation of preproduction costs from production costs.			
3. ACCOUNTING SYSTEM PROVIDES FINANCIAL INFORMATION:			
a. Required by contract clauses concerning limitation of cost (FAR 52.232-20 and 21) or limitation on payments (FAR 52.216-16).			
b. Required to support requests for progress payments.			
4. IS THE ACCOUNTING SYSTEM DESIGNED, AND ARE THE RECORDS MAINTAINED IN SUCH A MANNER THAT ADEQUATE, RELIABLE DATA ARE DEVELOPED FOR USE IN PRICING FOLLOW-ON ACQUISITIONS?			
5. IS THE ACCOUNTING SYSTEM CURRENTLY IN FULL OPERATION? (If not, describe in Section I Narrative which portions are (1) in operation, (2) set up, but not yet in operation, (3) anticipated, or (4) nonexistent.)			

(c) ADDITIONAL INFORMATION TO BE FURNISHED

(1) Business Systems

State whether all business systems, including but not limited to accounting, property control, purchasing, estimating, and employee compensation, which require Government acceptance or approval (as applicable) are currently accepted/approved without condition.

Provide the date of acceptance/approval for each system and the cognizant contract administration office. Explain any existing conditional acceptances/approvals and the compliance status of any systems(s) for which acceptance or approval is currently withheld.

FAR 16.301-3 requires that a contractor's accounting system be adequate for determining costs applicable to the contract prior to the award of a cost-reimbursement contract. The offeror shall provide evidence of an adequate accounting system as determined by the cognizant Defense Contract Management Agency (DCMA) for accumulating and reporting incurred costs. An adequate accounting system is not an evaluation criterion. It is a basic contract requirement with a pass/fail determination. A contract may only be awarded to the offeror(s) who are determined to have an adequate accounting system by DCMA.



GAO

Accountability • Integrity • Reliability

Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

Decision

Matter of: A-TEK, Inc.

File: B-299557

Date: May 3, 2007

Debbie Rieger for the protester.

Jonathan R. Celniker, Esq., and Michael J. Ettner, Esq., General Services Administration, for the agency.

Paul E. Jordan, Esq., and John M. Melody, Esq., Office of the General Counsel, GAO, participated in the preparation of the decision.

DIGEST

In procurement that will include cost-reimbursement task orders, agency reasonably rejected protester's proposal for lack of verification of federally audited accounting system as required by the solicitation.

DECISION

A-TEK, Inc. protests the rejection of its proposal as unacceptable, based on a requirement concerning the adequacy of the firm's accounting system, under request for proposals (RFP) No. TQ2006MCB0001, issued by the General Services Administration (GSA) for information technology (IT) services. A-TEK primarily asserts that the rejection is unreasonable because it furnished sufficient information to satisfy the requirement and, in any event, GSA is responsible for A-TEK's failure to meet the requirement.

We deny the protest.

The RFP anticipated the award of some 25 to 30 contracts under a multiple-award, indefinite-delivery/indefinite-quantity (ID/IQ) government-wide acquisition contract (GWAC) for a broad range of IT services, with a not-to-exceed ceiling of \$50 billion. Contractors were to provide all management, supervision, labor, facilities and materials necessary to perform on a task order basis, including cost-reimbursement orders. Awards were to be made on a "best value" basis, with proposals evaluated under two equally important technical factors—past performance and contract plan—which, combined, were significantly more important than price. Prior to the

evaluation under these factors, proposals were to be reviewed for acceptability on a pass/fail basis; those failing this review would not be considered further for award.

Proposals were required to include the Defense Contract Audit Agency's (DCAA), or other federal audit agency's, verification of "an accounting system that has been audited and determined adequate for determining costs applicable to this contract in accordance with [Federal Acquisition Regulation] FAR 16.301-3(a)(1)."¹ RFP § L.12.5, as amended. Any offeror that did not have audit verification but was "certain its accounting system has been determined adequate" could provide contact information from a cognizant auditing representative office. Id. Offerors were warned that their proposals would be rejected if the agency was unable to obtain audit verification. Id.

In response to this requirement, A-TEK's proposal provided information on its use of Deltek software for its accounting and job costs system; contact information for the contracting officer on two current contracts with cost-type task orders; and notice that it had submitted provisional billing rates to DCAA. A-TEK Proposal, Folder J. After GSA reviewed this information and contacted the listed references, it informed A-TEK that it could not verify that the firm's accounting system had been properly audited and deemed adequate. GSA requested additional contact information for verification purposes. In response, A-TEK repeated the information in its proposal, argued that the requirement was arbitrary, and requested that GSA conduct a pre- or post-award audit for offerors lacking audit verification. Thereafter, GSA notified A-TEK that its proposal had been rejected, and this protest followed.

A-TEK asserts that, even though it did not have a verified accounting system, the agency erred in rejecting its proposal because the firm met the RFP's requirements through its use of the Deltek accounting system, submission of provisional billing rates to DCAA for audit, and current contracts with cost-reimbursable-type task orders.²

¹ Under the provisions of FAR § 16.301-3(a)(1), a cost-reimbursement contract may be used only when a contractor's accounting system is adequate for determining costs applicable to the contract.

² A-TEK also asserted that the rejection of its proposal conflicted with RFP § L.12.5, as amended, which stated that offerors did not need a verified estimating system. This assertion is without merit. While the RFP provision advised that a verified estimating system was not required, it also provided that an offeror needed verification that its accounting system had been audited and deemed adequate. It was A-TEK's failure to meet this accounting system requirement, not the lack of a verified estimating system, that resulted in the rejection of its proposal.

In considering a protest of an agency's proposal evaluation, our review is confined to determining whether the evaluation was reasonable and consistent with the terms of the solicitation and applicable statutes and regulations. United Def. LP, B-286925.3 et al., Apr. 9, 2001, 2001 CPD ¶ 75 at 10-11. Offerors have the burden of submitting an adequately written proposal, and an offeror's mere disagreement with the agency's judgment concerning the adequacy of the proposal is not sufficient to establish that the agency acted unreasonably. Carlson Wagonlit Travel, B-287016, Mar. 6, 2001, 2001 CPD ¶ 49 at 3.

The evaluation here was reasonable. The RFP unequivocally required offerors to have DCAA or other federal audit agency verification that the firm's accounting system had been audited and determined adequate for determining costs applicable to the solicited work in accordance with FAR § 16.301-3(a)(1). Contact with DCAA revealed that A-TEK did not have any cost-reimbursement contracts in place; had never been audited by DCAA; and had never been subject to a pre-award survey of its accounting system. Further, A-TEK's submission of provisional rates was not relevant because it lacked any existing cost-type contracts. Agency Report, exh. D, at 3. Further, while the Deltek software is widely used by companies with adequate accounting systems, use of the software alone did not constitute verification that A-TEK's accounting system had been audited and verified as adequate. Id. With regard to A-TEK's other contracts, GSA learned that those contracts contained provisions that specifically prohibited the firm from submitting a proposal for a cost-reimbursement-type task order because it had not had its accounting system audited and deemed adequate for those contracts. Id. at 3-4. While A-TEK also submitted a letter from its accountant, the agency found that it was insufficient to meet the RFP's requirements because it was not from a federal audit agency, it clearly stated that the accountant had not audited A-TEK's accounting system, and it failed to state that A-TEK's system had been deemed adequate for this contract. In short, A-TEK failed to provide any information that satisfied the RFP requirement. Based on A-TEK's failure to provide the required information, the agency reasonably concluded that the firm lacked a properly audited accounting system, and thus reasonably rejected the firm's proposal.

A-TEK has not challenged or refuted GSA's findings. Instead, it simply asserts that, since only the government can request and perform the required audit, meeting the requirement is beyond the firm's control, and it should not be penalized as a result. In this regard, A-TEK now asserts that the RFP requirement was ambiguous because it understood that filing its indirect rates and waiting for the government to take the necessary action was sufficient to meet the requirement. Comments at 1.

A solicitation ambiguity exists where two or more reasonable interpretations of the terms of the solicitation are possible. Ashe Facility Servs., Inc., B-292218.3, B-292218.4, Mar. 31, 2004, 2004 CPD ¶ 80 at 10. To be reasonable, an interpretation must be consistent with the solicitation read as a whole and in a reasonable manner. Malkin Elecs. Intl, Ltd., B-228886, Dec. 14, 1987, 87-2 CPD ¶ 586 at 4.

There is nothing ambiguous in the RFP provision at issue; again, it clearly required offerors to include verification of an audited and adequate accounting system, and warned that failure to do so would result in rejection of their proposals. Contrary to A-TEK's reading of the RFP, nothing in the solicitation supports its interpretation that an offeror awaiting an audit will meet the requirement. In fact, prior to submitting its proposal, A-TEK was well-aware that the agency did not share this interpretation. In this regard, A-TEK had complained about its difficulty in obtaining a DCAA audit and asked GSA to revise its requirement to allow firms to compete that could show evidence of indirect rates on file with DCAA at the time of proposal submission. Protest, exh. A, Question No. 467. The agency responded unequivocally that there was no requirement for audited rates, but reiterated the requirement for DCAA or federal civilian audit agency evidence of an adequate accounting system to be in place by the time of proposal submission in order to be considered for award. Id. A protest based on alleged solicitation improprieties that are apparent prior to the closing time for receipt of proposals must be filed before that time. Bid Protest Regulations, 4 C.F.R. § 21.2(a)(1) (2006). Since the RFP clearly required offerors to include verification of an audited and adequate accounting system, and did not provide for the alternative A-TEK suggests, and since A-TEK was aware of the agency's interpretation prior to the closing time, it was required to protest prior to that time. A-TEK did not protest on this basis prior to the closing time; accordingly, this aspect of the protest is clearly untimely and will not be considered.

The protest is denied.

Gary L. Kepplinger
General Counsel